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IN THE

# Supreme Court of the United States

MISSOURI GAS ENERGY,
*Petitioner*,

v.

MONICA SCHMIDT,
WOODS COUNTY, OKLAHOMA ASSESSOR,
*Respondent*.

**On Petition for a Writ of Certiorari to the Supreme Court of Oklahoma**

## SUPPLEMENTAL BRIEF OF PETITIONER IN RESPONSE TO THE BRIEF OF THE UNITED STATES

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## SUPPLEMENTAL BRIEF OF PETITIONER IN RESPONSE TO THE BRIEF OF THE UNITED STATES

The United States acknowledges that the issues raised in Missouri Gas Energy's ("MGE") Petition have not yet been decided by this Court:

> This Court has not yet decided whether or to what extent *Complete Auto* displaces the older line of "continuity of transit" cases in the specific context of state ad valorem taxes on goods temporarily held in storage during the course of interstate transport.

U.S. Br. 10. The United States even agrees that "the 'continuity of transit' cases remain potentially relevant to the constitutional analysis" and that the

factors "considered to determine continuity of transit may inform the first prong of the *Complete Auto* inquiry." U.S. Br. 12. Notwithstanding these admissions, the United States endorses the Oklahoma Supreme Court's decision that expressly rejects directly applicable precedent – the "continuity of transit" cases. U.S. Br. 6. The government's brief fails to reconcile the Oklahoma Supreme Court's decision with this Court's precedent and, therefore, adds confusion regarding the continued relevance of the "continuity of transit" cases.

1. The test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) was not written in a vacuum, and this Court has made clear that *Complete Auto* did not overrule all of this Court's precedent regarding taxation of interstate commerce. *See Quill Corp. v. North Dakota*, 504 U.S. 298, 309-21 (1992). MGE's position is, and always has been, that the *Complete Auto* test provides the framework to analyze Commerce Clause limitations on a state's authority to tax; but the "continuity of transit" cases inform what is needed to establish a "substantial nexus" under the first prong of the *Complete Auto* test. *See* Pet. 17; Reply 2-3. If a state's attempt to tax goods in transit does not pass the "continuity of transit" test, there is no nexus sufficient to allow the state to tax those goods under *Complete Auto*.

2. The United States says that the Oklahoma Supreme Court "did not ignore the 'continuity of transit' test," but there is no legitimate question that it did just that. U.S. Br. 13. The Oklahoma Supreme Court wrote: "[w]ere the court making the old 'in transit' or 'at rest' determination, this record would make that determination very difficult." Pet. 31a ¶52. Accordingly, the Oklahoma Supreme Court

found the "continuity of transit" test "inconclusive" and replaced it with an amorphous "nexus" analysis. Pet. 31a ¶52. The Oklahoma Supreme Court erred in rejecting directly applicable precedent from this Court and its decision reflects, at a minimum, the confusion that exists regarding the continued viability of this Court's "continuity of transit" cases.[1] MGE respectfully urges this Court to resolve that confusion.[2]

3. Contrary to the United States' suggestion on page 13 of its Brief, there is a "pronounced difference" between application of the "continuity of transit" test and the framework applied by the Oklahoma Supreme Court – the "continuity of transit" test is

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[1] The United States suggests that *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) has clarified this issue. U.S. Br. 11. *D.H. Holmes*, however, concerned a use tax, not an "attempt[] to tax only the existence of goods within the State." 486 U.S. at 31. None of the cases the government cites on page 11 of its Brief addresses the impact (if any) of *D.H. Holmes* on a property tax. In fact, only two of the cases cited on page 11 involved a property tax. Those two courts analyzed both the "continuity of transit" cases and *Complete Auto*, but failed to address how those lines of authority fit together. *See Peoples Gas, Light, & Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d 208, 215-218 (Tex. App.—Texarkana 2008, pet. filed); *Midland Cent. Appraisal Dist. v. BP Am. Prod. Co.*, 282 S.W.3d 215, 222-223 (Tex. App.—Eastland 2009, pet. filed).

[2] The United States attempts to minimize the confused state of the law in this area by noting repeatedly the lack of a conflicting decision by a federal court of appeals. U.S. Br. 6, 7, 21. This is a red herring. Of course, there are no conflicting federal court of appeals decisions because Congress did not grant federal district courts the authority to adjudicate matters of state taxation except in the rare case where state courts do not provide a "plain, speedy and effective remedy." *See* 28 U.S.C. §1341.

dispositive. None of the judges who have reviewed this case found the Assessor's tax on MGE valid under the "continuity of transit" test. The district court as well as the dissenting Judge on the Oklahoma Supreme Court got it right. They found the tax unconstitutional because any gas MGE placed into the Panhandle Eastern pipeline system was "in transit" and in the possession and control of a common carrier. Pet. 54a, 72a-75a ¶¶17, 19, 22, 38. The Oklahoma Supreme Court found this issue too close to call. Pet 31a ¶52. The analysis should have ended there.

4. This Court has not replaced its "continuity of transit" test with an amorphous "nexus" analysis to determine when a state can tax goods temporarily stored during interstate transport. Doing so would reflect a radical shift in analysis. The "continuity of transit" analysis focuses on the intentional activities of the taxpayer and the reasons goods are stored within a state.[3] If the tax passes the "continuity of transit" test, a state can reasonably conclude that the taxpayer has purposefully subjected itself to the state's taxing jurisdiction. The Oklahoma Supreme Court's approach reflects the polar opposite view. The Oklahoma Supreme Court started with a presumption that Oklahoma has the right to tax goods that it can find within the state on the tax assessment day regardless of how, when, where, or why those goods arrived in the state. *See* Pet. 19a-20a ¶33, 30a ¶50, 31a ¶52. Then, to implement its untenable approach, the Oklahoma Supreme Court allowed the use of an allocation formula to determine

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[3] Each of the "continuity of transit" cases cited on pages 14-16 of the United States' Brief focuses on the taxpayer's activities when determining whether to sustain a state tax.

who owned what quantity of gas in Oklahoma for tax purposes.

The Assessor's use of an allocation formula results in a tax on MGE based solely on its decision to place natural gas into an interstate pipeline system that happened to have a gas storage facility in Oklahoma. Accordingly, the Assessor's decision to tax MGE is not based on any actions that MGE intentionally directed in or toward Oklahoma; it is based on the actions of the common carrier that determined how, when, and where to move and store gas in the pipeline system. As the United States explains: "the effect of the apportionment formula is to tax an equivalent percentage of gas stored by the pipeline for a shipper *regardless of where it was purchased, supplied, or stored*." U.S. Br. 18 (emphasis added).

The United States further highlights its focus on the pipeline operator's actions when it writes that it is "reasonable" to allocate a share of the Oklahoma tax burden to all shippers using the system because "regardless of the location at which a particular shipper supplies gas to a pipeline, the pipeline operator may deliver gas to that shipper from wherever in the pipeline system the operator chooses." U.S. Br. 18. Neither the United States nor the Oklahoma Supreme Court cites any authority for this unprecedented shift in constitutional analysis away from the taxpayer's own activities. Allowing this shift would set a dangerous precedent because it would subject a taxpayer to taxation in any state or county in which a common carrier decided to temporarily store the taxpayer's goods.[4] To follow the government's sug-

[4] Although the United States argues that the use of an ownership allocation formula is "reasonable" under the circumstances, the United States does not dispute that reallocating

gested analysis would subject shippers of gas held in the pipeline itself to taxation in every state in which the pipeline is located. *See* INGAA Amicus Br. 13-14. Taxpayers are not subject to jurisdiction in a forum state based solely upon the unilateral decisions of a common carrier. *See Quill*, 504 U.S. at 311, 315.

5. MGE has shown that the Assessor's use of an allocation formula impermissibly discriminates against interstate commerce by reallocating ownership interests across state lines. *See* Pet 27-29. Without citing any authority, the United States attempts to dispute that point, writing:

> That formula might remove an incentive that would otherwise exist to supply gas to the pipeline at an out-of-state location (in order to ensure that the gas supplied would be stored in Kansas), but it does not create an affirmative incentive to buy gas in Oklahoma.

U.S. Br. 18-19. In *Hunt v. Washington State Apple Adver. Comm'n*, by contrast, this Court recognized that a state law is discriminatory if it has the effect of removing the economic advantage that out-of-state goods otherwise enjoy. 432 U.S. 333, 351 (1977). *See also West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194-96 (1994) (citing numerous cases holding that a state may not enact regulations that remove the economic advantages associated with out-of-state

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ownership across state lines necessarily results in an impermissible "extraterritorial effect." *Compare* Pet 24-27 *with* U.S. Br. 17-18. Under the United States' view, so long as MGE elects to do business with an interstate pipeline that has a storage facility in Oklahoma, there is nothing MGE can do to avoid state ad valorem taxes in Oklahoma even if MGE buys all of its gas in Texas or Kansas, contracts for a Kansas storage delivery point (as it did in this case), and seeks ultimate delivery in Missouri.

goods). By acknowledging that use of the allocation formula might "remove incentives" to do business out-of-state, the United States actually admits that the formula used is discriminatory.

6. MGE also demonstrated that the use of an ownership allocation formula results in an unconstitutional risk of multiple taxation. *See* Pet. 29-30. The United States does not deny that this risk exists. *See* U.S. Br. 19-20. Instead, the United States explains that this harm "has not yet materialized (and may never do so)." U.S. Br. 6, 19-20. But this is the wrong constitutional test. *See Armco, Inc v. Hardesty,* 467 U.S. 638, 644-45 (1984) (rejecting the requirement that a taxpayer must show it was actually subjected to multiple taxation); *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 242 (1987) (a state may not subject a taxpayer to a *risk* of multiple taxation). Here, the risk of multiple taxation is real. Not only have Oklahoma, Kansas, Louisiana, and Texas tried to tax natural gas in storage as illustrated in MGE's Petition, MGE understands that other states, including Mississippi and Kentucky, are now assessing taxes on gas in storage too. Given that there are more than 200 storage facilities located in 24 states,[5] this risk is only going to grow.[6]

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[5] JURISDICTIONAL STORAGE FIELDS IN THE UNITED STATES BY LOCATION, http://www.ferc.gov/industries/gas/indus-act/storage/fields-by-location.pdf.

[6] Imposing a tax on natural gas temporarily stored in interstate pipeline systems is an attractive, albeit unconstitutional, way for a state to raise revenues because the parties who will ultimately bear the tax burden are often consumers in other states who have no political voice in the taxing state. Indeed, by imposing a tax on MGE, which is a local gas distribution com-

7. That the allocation formula used by the Assessor appeared in a FERC tariff does not change the analysis. While it is not surprising that the United States would support an expansive view of FERC's jurisdiction, there is no authority to show that Congress ever delegated to FERC the power to allocate ownership of gas for purposes of state taxation. *Compare* Reply 8 with U.S. Br. 20. The United States claims that "FERC has authority to disapprove a tariff specifying an objectionable allocation formula," *see* U.S. Br. 6-7, but the United States does not explain where FERC receives any authority to adjudicate or resolve constitutional questions regarding the validity of state ad valorem taxes.[7] Thus, the United States' argument that "FERC always possesses the authority to disapprove a tariff specifying an allocation formula that the agency regards as inconsistent with statutory directives governing interstate transportation of natural gas," U.S. Br. 20, is meaningless because FERC has no "statutory directives" addressing this issue. FERC simply is not in the business of regulating or allocating state property taxes.

The primary problem presented in this case, though, is not whether the allocation formula used is

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pany operating in Missouri, Oklahoma has effectively shifted the burden of its taxes to gas consumers in Missouri.

[7] Although the United States suggests that no one challenged the inclusion of the allocation formula in Panhandle Eastern's tariff when it was approved in the 1990's, the United States fails to recognize that, before this case, Oklahoma was not even attempting to tax natural gas temporarily stored in interstate pipeline systems. It is undisputed that this case involves a decision made by the Assessor in 2001 to retroactively seek the collection of taxes for gas in storage in 1997, 1998, and 1999.

"objectionable"—the primary issue is whether a state may tax goods temporarily stored while in transit in an interstate pipeline system. The fact that the Oklahoma Supreme Court allowed the Assessor to use an unconstitutional allocation formula as a "solution" to the difficult question of who to tax is strong evidence that the Oklahoma Supreme Court should not have allowed the Assessor to tax anyone for the gas temporarily being held in storage in Woods County.

8. The United States' attempt to collapse the Due Process and Commerce Clause limitations on a state's ability to tax interstate commerce directly conflicts with this Court's precedent. Without citing any authority, the United States writes: "[b]ecause the nexus between Oklahoma and the 'large volumes of gas' stored there 'for a substantial part of the year' . . . is sufficient to satisfy prong one of the *Complete Auto* test, . . . it is *a fortiori* sufficient to satisfy due process." U.S. Br. 21. In *Quill Corporation v. North Dakota*, however, the Court recognized that the Due Process and Commerce Clauses "pose distinct limits on the taxing authority of the States," and "reflect different constitutional concerns." 504 U.S. 298, 305 (1992). In *D.H. Holmes Co. v. McNamara*, the Court explained that even if the "continuity of transit" test no longer applies to the Commerce Clause analysis of certain types of taxes such as state use taxes, that test still "may be of some importance for other purposes (in determining, for instance, whether a 'taxable moment' has occurred . . .)." 486 U.S. 24, 31 (1988). The Due Process question presented in this case is whether a taxable moment has occurred—whether MGE's gas has come to rest in Oklahoma and acquired a tax situs sufficient to impose a state

property tax. This is not the same question as presented under the Commerce Clause.

The United States' Due Process arguments are troubling. This Court's Due Process cases focus on the intentional activities of a taxpayer and whether the taxpayer has purposefully availed itself of the benefits of the forum state's laws. *See, Quill*, 504 U.S. at 306-08. When a taxpayer purposefully directs activity toward a particular state, there is little doubt that the state may impose taxes arising from that activity. *Id.* at 308. But when a party's goods end up in the state through the unilateral actions of others, the party has not necessarily subjected itself to that state's jurisdiction. *See World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 295-97 (1980). The test is whether activities are purposefully directed at the state, and not just whether it is foreseeable that the goods might end up there. *Id.*

By contrast, the analysis endorsed by the United States and the Oklahoma Supreme Court ignores MGE's actions, focusing instead on the activities of a common carrier and the use of an allocation formula. Thus, the United States makes the astounding assertion that a state may permissibly tax MGE's gas "regardless of where [gas] was purchased, supplied, or stored." U.S. Br. 18. The district court correctly rejected the Assessor's attempt to tax MGE because, among other reasons, the taxes assessed against MGE for gas purportedly stored in Oklahoma "bear no correlation" to the gas MGE actually placed in the system that could possibly be stored in Oklahoma. *See* Pet. 69a-70a ¶40. This Court should grant review of this case to eliminate the confusion as to the Due Process limits on a state's ability to tax goods that

are only temporarily stored within a state as part of their interstate journey.

9. Throughout its Brief, the United States suggests that the constitutional concerns raised in this case are "premature" and that "there is no pressing need for the Court's intervention now." *See* U.S. Br. 7, 17. But the amicus briefs filed by the Interstate Natural Gas Association of America ("INGAA") and the American Gas Association ("AGA") tell a different story. Both INGAA (representing the interstate pipeline companies) and AGA (representing local gas distribution companies who are shippers of gas in the interstate pipelines) have joined MGE in requesting immediate review of the constitutional issues raised in the Petition. Significant resources are being expended by taxpayers, tax assessors and the judicial system to litigate these issues right now. MGE respectfully suggests this Court should not wait to resolve the issues regarding the extent to which a state may impose ad valorem tax on gas moving within the interstate system.

This Court should grant the Petition.

Respectfully submitted,

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